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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No. 71-1378

INTERCONTINENTAL INDUSTRIES, INC.,
Petitioner,

v.

AMERICAN STOCK EXCHANGE and SECURITIES AND EXCHANGE COMMISSION,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF RESPONDENT AMERICAN STOCK EXCHANGE

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Opinions Below

The opinion of the Court of Appeals for the Fifth Circuit is reported at 452 F.2d 935 (Pet. App. A). The opinion and order of the Securities and Exchange Commission are not yet reported (Pet. App. B).

Jurisdiction

The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1). The judgment of the Court of Appeals for the Fifth Circuit was entered on December 20, 1971. On March 9, 1972 petitioner was granted an extension of time to file

its petition until April 25, 1972 and the petition was filed on that date. Respondent, American Stock Exchange was granted permission on June 16, 1972 to file its brief in opposition to the petition on or before June 30, 1972.

Question Presented

Were the procedures followed by the American Stock Exchange in delisting petitioner's stock, on the grounds that it had disseminated and permitted the dissemination of materially inaccurate, incomplete and misleading information to the public concerning a proposed acquisition and merger, in accord with due process of law?

Constitutional and Statutory Provisions Involved

The Fifth Amendment to the Constitution of the United States provides:

> "No person shall . . . be deprived of life, liberty, or property, without due process of law . . ."

Title 15 United States Code, Section 781(d) (Section 12(d) of the Securities Exchange Act of 1934, as amended) provides:

> "A security registered with a national securities exchange may be withdrawn or stricken from listing and registration in accordance with the rules of the exchange . . . upon application by . . . the exchange to the Commission . . ."

Statement

Petitioner asks this Court to review a decision of the Court of Appeals for the Fifth Circuit which affirmed an order of the Securities and Exchange Commission ("Commission") granting an application of the Ameri-

can Stock Exchange ("Exchange") to strike petitioner's stock from listing and registration on the Exchange. The Commission found that the Exchange was justified in its conclusion that petitioner's stock should be delisted since Intercontinental Industries, Inc. ("INI") had breached its listing agreement with the Exchange which requires prompt and accurate public disclosure of all significant corporate developments. The Commission also found that there was no substantial dispute as to the nature of the information disseminated or the fact that it was misleading in material respects (Pet. App. B3). Finally, the Commission concluded that (1) despite the obvious misleading nature of the statements issued by or about petitioner, it failed to take prompt corrective action and (2) the Exchange gave petitioner a fair hearing before filing an application for permission to delist the INI stock.

The petitioner to date has not controverted the basic facts since, under the circumstances, it is clear that the decisions of the Exchange and the Commission were based on statements issued by INI. The review sought here then is limited to alleged deficiencies in the procedure used by the Exchange in reaching a decision to file its delisting application with the Commission. A review of the facts and procedures in question should be helpful in determining whether or not the petition has merit.

INI announced on April 11, 1969, that it was negotiating to acquire 81% of the outstanding stock of an unnamed modular home builder. Mr. S. Mort Zimmerman, Chairman and President of INI, was quoted as stating, "the unnamed builder has about $130,000,000 in orders on hand" and that the "contemplated acquisition amounts to a medium seven figures". This announcement was carried on the Dow Jones broad tape and by the financial press.

On April 15, 1969, INI made a second announcement concerning this acquisition indicating that it had agreed to acquire 81% of Prebuilt Homes, Inc. (hereinafter called

"Prebuilt"), described as a "Detroit home builder", for not more than 300,000 shares of INI stock, the exact number to depend on the earnings of Prebuilt over a five-year period. In this announcement Mr. Zimmerman stated that Prebuilt had orders to build more than 9,800 homes, including 800 pre-finished modular homes for the Metropolitan Detroit Citizens Development Authority. This announcement was also carried on the Dow Jones broad tape and by the financial press.

The impact of these announcements on the price and trading volume of INI stock on the Exchange was immediate and dramatic. The average weekly volume in the stock during the last three weeks of March and the first week of April 1969, was approximately 7,000 shares and the stock was selling in a price range of approximately $11 to $13. On Friday, April 11, the day of the first announcement, 18,600 shares of INI stock were traded on the Exchange and it closed at $15½, up 2½ points for the day During the succeeding five weeks the stock continued to increase in price on substantial trading volume.

On May 20, 1969, INI issued a further press release indicating that a definitive contract for the purchase of an 81% interest in Prebuilt had been executed. The following week, volume was 233,300 shares and the stock reached a high of $31¼ on June 13, almost triple the price at which it was selling during the month prior to the announcement of the proposed acquisition of Prebuilt (Pet. App. A3, B7).

During this period, additional publicity was being given to the INI acquisition of Prebuilt. Written materials prepared by Prebuilt were distributed to persons in the securities industry and others which indicated that as of April 1, 1969, Prebuilt had orders and proposals on hand for 9,039 housing units, amounting to a sales volume of over $116 million. There were also projections in these written materials indicating annual sales of about $141

million and net earnings of about $10 million by 1973, and cumulative sales and earnings for the five-year period 1969-1973 of approximately $392 million and $29 million, respectively. A Wall Street Journal article on June 3, 1969 reported a securities analyst's statement that an INI official had predicted Prebuilt's earnings would "jump" from an anticipated $100,000 in the fiscal year ending July 31, 1970 to $9 million three years later; sales would rise from $5.5 million to $97 million in the same period, and there would be a meteoric rise in INI's consolidated earnings from an estimated $425,000 in the current fiscal year to $10 million in the year ending July 31, 1973 (Pet. App. B4).

On a number of occasions during this period Exchange representatives contacted INI officials with regard to the publicity and increased market activity, but nothing was disclosed by INI suggesting that the announcements concerning Prebuilt may have been inaccurate or misleading. On June 4, 1969, INI's President and Vice-President were cautioned by Exchange officials with respect to their responsibilities to insure fair and accurate disclosure in view of the optimistic projections and estimates being published about INI and Prebuilt (Pet. App. B10).

In an announcement on June 13, 1969, INI stated that it had joined with Capital Bancshares, Inc. (a company controlled by INI's President) to purchase 4.3% of the outstanding stock of Central Foundry Company for $1 million and that INI and Bancshares intended to propose uniting the two companies with Central Foundry. The announcement included pro forma figures with respect to total assets, net worth, total sales and net income of the three companies combined. Press accounts of this announcement appearing on June 16, 1969, also quoted INI's President, S. Mort Zimmerman, as stating that he understood the management of Central Foundry was sympathetic to the proposed combination of the three companies.

As a result of this announcement and the continued trading activity, the Exchange halted trading in INI's stock on June 19, 1969, and sought to obtain clarification of the statements made by INI. In meetings with officials of INI and Prebuilt subsequent to the trading halt, the Exchange first learned of the misleading and inaccurate nature of the statements which had been made by INI during the previous two and a half months. The Commission also commenced an investigation and on June 26, 1969, it suspended all trading in INI stock.

During the following six weeks, the Exchange staff had numerous and lengthy meetings with INI officials and its counsel, probing all aspects of the proposed acquisitions and the misleading nature of the information that had been published in connection therewith (Pet. App. B10, B12). Concurrently, the staff of the Commission was proceeding with its investigation to determine the extent to which the inaccurate and misleading information disseminated by INI and its officers violated the Federal securities laws.

As a result of its investigation, the Commission brought an action against INI, Prebuilt and certain of their officers and directors, alleging they violated the antifraud provisions of the securities acts in disseminating false or misleading information concerning Prebuilt. On July 15, 1969 a consent decree was entered prohibiting any further activities of the nature alleged in the Complaint. After INI released a six-page letter to shareholders dated July 18, 1969, commenting on the various matters which had been raised by the Exchange and the Commission and advising of the permanent injunction issued as a result of the Commission's action, the Commission terminated its suspension order, thereby permitting the resumption of over-the-counter trading in INI's stock. During the first week of such trading, the high and low bid/asked quotations for the stock were $9½ and $5⅝ respectively (Pet. App. B7).

In its letter to stockholders, INI disclosed material information concerning the Prebuilt acquisition and Prebuilt's business and the proposed consolidation of INI with Bancshares and Central Foundry. The facts disclosed in the letter confirmed that the previous announcements by INI and information disseminated by its officers and directors and by persons associated with Prebuilt were inaccurate, incomplete and misleading. For example, as noted in the opinion below, it was admitted that (Pet. App. A4):

> "(a) At the time of the April announcements Prebuilt had no plant in operation, had not produced any modular homes, had only nominal tangible assets, and had no history of operations except that two of its officials had been associated with a company which had produced some prototypes and which currently was in bankruptcy.
>
> (b) Prebuilt had no signed contracts to build modular homes. Although it had an award from the Metropolitan Detroit Citizens Development Authority, no contract has been signed.
>
> (c) The reference to $130 million of orders was based on a letter of commitment from one of Prebuilt's own officers, who could not have purchased these homes with his own resources, but had to depend upon his ability to resell them.
>
> (d) The projections of Prebuilt's earnings did not disclose that Prebuilt was bound to pay three of its officers 81% of its earnings above $5.2 million.
>
> (e) The pro forma figures relating to INI, Bancshares and Central Foundry had been substantially overstated.
>
> (f) The directors of Central Foundry had received no proposal and made no commitment concerning possible merger with INI and Bancshares."

Prior to issuing its July 18th letter to shareholders, INI was notified by the Exchange that it was considering the question of delisting INI's stock in view of INI's failure to comply with the Exchange's timely disclosure policies, and a statement to that effect was included in the letter. Thereafter, on July 25, 1969, the Exchange wrote to INI stating that the matter of delisting was under review and offering INI an opportunity for a hearing before the Exchange's Committee on Securities to present such facts as the company felt might have a bearing on the matter. In its letter the Exchange clearly indicated the rules and policies of the Exchange which had been violated, the manner in which they had been violated and the fact that the Exchange was considering the question of whether it was in the best interests of the investing public to continue the listing (Pet. App. A11, B13. The full text of the letter is set forth in the Appendix hereto).

INI advised that it wished to take advantage of the opportunity for a hearing, and a meeting of the Committee was scheduled for August 6, 1969. The hearing before the Committee lasted for more than four hours and each of the persons whom INI called to furnish information was heard. INI was given full and unlimited opportunity to present any facts which it considered relevant to the question of its continued listing, and to make any arguments which it deemed pertinent. Prior to the beginning of the hearing, the Exchange offered to call in a reporter so that a transcript of the proceedings could be made. This offer was declined by counsel for petitioner (Pet. App. A5, B13).

Thereafter, the Committee determined to recommend delisting to the full Board of Governors of the Exchange. The Board unanimously approved the recommendation and authorized the filing of the delisting application with the Commission.

INI opposed the delisting before the Commission and submitted a lengthy memorandum stating its position.

However, it offered no additional facts and raised no issues which had not been considered by the Exchange's Committee on Securities or its Board of Governors. The Commission determined that "no useful purpose would be served by the presentation of oral argument to us, as requested by INI" and granted the application to delist the stock of INI (Pet. App. B13-14).

ARGUMENT

Where the exchange gave notice, an opportunity to answer charges and a fair hearing there is no denial of due process of law in concluding thereafter that petitioner's stock should be delisted.

Pursuant to the provisions of the Securities Exchange Act of 1934, the national securities exchanges retain responsibility for regulation of the securities listed on their respective exchanges. As this Court noted in *Silver* v. *New York Stock Exchange,* 373 U.S. 341, 352 (1963):

> "The intention was . . . as Mr. Justice Douglas said, while Chairman of the S.E.C. one of letting the exchanges take the leadership with government playing a residual role. Government would keep the shotgun, so to speak, behind the door, unload, well oiled, cleaned, ready for use but with the hope it would never have to be used."
>
> • • •
>
> "Thus arose the federally mandated duty of self-policing by exchanges. Instead of giving the commission the power to curb specific instances of abuse, the Act placed in the exchanges a duty to register with the Commission, § 5, 15 U.S.C. § 78e, and decreed that registration could not be granted unless the exchange submitted copies of its rules, § 6 (a) (3), 15 U.S.C. § 788 (a) (3), and unless such rules were just and adequate to insure fair dealing and to protect investors,' § 6 (d)."

The burden then is in the first instance on the exchange to adopt rules, standards and procedures appropriate for the protection of investors, including, where warranted, procedures for delisting securities. This basis function under the Act was discussed in *Exchange Buffet Corporation* v. *New York Stock Exchange*, 244 F 2d 507 (1957), where Judge Medina stated (244 F. 2d 510):

> "One of the main purposes of the Act was the protection of investors and prospective investors. Future purchasers of securities are those peculiarly in need of the sort of protection which is afforded by delisting."

Consistent with its duties under the Act, the Exchange requires in its listing agreements, with each company whose stock is traded on the Exchange, that the company "will make prompt public disclosure of any material development in its affairs and operations, whether favorable or unfavorable, which might significantly affect the market for its securities or influence investment decisions." This requirement as to public statements is further explained in the listing agreements as follows (Pet. App. A7-8):

> "It is expected that such statements will be factual and that judgment and restraint will be used in not publicizing information which may be construed as over-optimistic, slanted or promotional—such as estimates and forecasts not warranted by existing circumstances, premature statements of mergers or acquisitions or descriptions of new products still in the experimental stage, the commercial feasibility of which is problematical, etc."

Petitioner's conduct must be evaluated in the context of the duties imposed on the Exchange by the Act and the policies of the Exchange reflected in its agreements with listed companies, including petitioner. In violation of these obligatory standards of disclosure intended for the protection of investors, in April of 1969 petitioner unleashed

or condoned a series of grossly inaccurate and misleading statements concerning its present and future operations. Despite its knowledge of the requirements of fair disclosure and express warnings by officials of the Exchange, nothing was done by petitioner to correct the unwarranted published statements until July, 1969 after it had been sued by the Commission and a consent judgment was entered. Only then, in its letter of July 18, 1969 to its stockholders, did petitioner "clarify" the earlier statements. This letter, when compared with the misleading, incomplete and inaccurate statements of April-June, 1969, is all the evidence needed to sustain the decision below. Its significance was noted by the court below when it stated (Pet. App. A12):

> "Virtually all of the material facts had been admitted by INI in its letter to the stockholders on July 18 and are not really disputed by INI now. In fact, INI can hardly do so because if the facts in that letter are incorrect, then the letter itself, uncorrected, becomes a violation of the requirement of full disclosure."

Finally, apprised by petitioner's own admissions of the extent to which investors had been misled by the statements in April—June, 1969, the Exchange, in its letter of July 25, 1969, notified INI of its intention to reach a determination as to whether or not the INI stock should be delisted. INI was offered and accepted an opportunity to present witnesses and evidence on this question at a hearing of the Exchange's Committee on Securities.

On the hearing day, petitioner appeared by counsel, with witnesses and documents. Counsel for INI declined the offer of the Exchange to bring in a reporter and make a transcript of the proceedings. INI then adduced testimony from all of its witnesses over a four-hour period. After the close of the hearing, the Committee recommended and the Board of Governors unanimously agreed that a delisting application should be filed with the Commission. The petition before this Court is devoted almost entirely to an

attack on the procedure followed by the Exchange before, during and shortly after the hearing by the Committee on Securities.

Petitioner asserts it was deprived of due process of law and complains particularly of (1) lack of notice, (2) lack of an opportunity to confront and cross-examine adverse witnesses, (3) improper mixing of functions of the Committee on Securities, whose members sat with the Board of Governors while the Board determined to file the delisting application, and (4) the refusal of the Board to permit INI to appear before it and the failure of the Commission to hold a leaving. Each of these contentions was considered and properly disposed of by the court below.

1. The "notice", i.e., the letter from the Exchange to INI dated July 25, 1969 annexed as an appendix hereto, was certainly formal enough to enable INI to prepare any defense it might have to the charges it had violated the disclosure requirements of the Exchange. This was not a new thought. Warnings had been given by Exchange officials weeks before. The Commission had sued to stop the improper announcements. A consent judgment had been entered, and INI had published its letter of July 18 which laid bare the misleading quality of the earlier statements. Under these circumstances, the notice met any reasonable standard of due process. *Mullane* v. *Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950).

2. The nature of the hearing did not require a formal trial type procedure. The material facts were never disputed. The improper statements were known to all as was the effect these statements had on the price of INI stock. The question was, what INI did to correct these misleading statements, if anything, and when it acted. There were no adverse witnesses needed to prove the basic facts—the proof came from INI. Cross-examination would serve no purpose in this situation. Due process does not require futile action which would simply prolong the pro-

ceeding without developing the facts. Exchange officials had no unique knowledge of their own. INI had the facts and was given an opportunity to present them fully. Cross-examination was unnecessary. *Dixon* v. *Alabama State Board of Education,* 294 F. 2d 150 (C.A. 5, 1961), cert. denied, 368 U.S. 930 (1961); *Wright* v. *Texas Southern University,* 392 F. 2d 728 (C.A. 5, 1968).

3. Petitioner's complaint about mixed functions of the Committee on Securities is not substantial. It is hardly novel law that an organization—even a governmental agency—may combine investigatory, accusatory and adjudicatory functions. *Federal Trade Commission* v. *Cement Institute,* 333 U.S. 683 (1948); *Federal Trade Commission* v. *Cinderella Career and Finishing Schools, Inc.,* 404 F. 2d 1308 (C.A.D.C., 1968); *San Francisco Mining Exchange* v. *Securities and Exchange Commission,* 378 F 2d 162 (C.A. 9, 1967).

4. Due process does not require a series of hearings. One is sufficient. Petitioner's claim that it should have had subsequent hearings before the Board of Governors and the Commission is unsupportable. INI had its opportunity to present any evidence it thought relevant at the hearing before the Committee on Securities. Further hearings thereafter, particularly where there was, and still is, no reason to believe new evidence of substance could be adduced, were not required by any accepted standards of due process. *Goldberg* v. *Kelly,* 397 U.S. 254, 267 (1970).

The procedural protection needed to meet standards of basic fairness vary with the circumstances, as this Court has observed: "The Fifth Amendment gurantees no particular form of procedure; it protects substantial rights." *Labor Board* v. *Mackay Co.,* 304 U.S. 333, 351 (1938). The requirements of due process "are not technical, nor is any particular form of procedure necessary." *Inland Empire Council* v. *Millis,* 325 U.S. 697, 710 (1945). "The very nature of due process negates any concept of inflexible procedures universally applicable to every imaginable situa-

tion." *Cafeteria & Restaurant Workers* v. *McElroy*, 367 U.S. 886, 895 (1961).

Here, statements made by and about INI misled the investing public. Months went by before these statements were corrected. Nothing was or could have been produced at a hearing to change these facts. Neither a formal indictment nor a conventional trial is needed to support administrative action under these circumstances. INI received adequate notice, an opportunity to be heard and an impartial decision. More is not required.

The policy of full disclosure enforced here by the Exchange and approved by the Commission implements the Congressional plan of self-regulation inherent in the Securities Exchange Act. Petitioner's violation was clear. The procedure used in delisting its stock was consistent with the requirements of due process. The decision of the Commission in a matter of this sort is entitled to great weight. *Atlas Tack Corporation* v. *New York Stock Exchange*, 246 F. 2d 311, 319 (C.A.5 1957). The review by the Circuit Court below of all issues raised here was complete and persuasive. Petitioner has shown no reason warranting a further review by this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX

Letter to Petitioner, Dated July 25, 1969

AMERICAN STOCK EXCHANGE
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Joseph A. DeRose
Vice President
Securities Division

July 25, 1969

Mr. S. Mort Zimmerman
Intercontinental Industries, Inc.
111 Braniff Building
Dallas, Texas

[P. 1]*

Dear Mr. Zimmerman:

As we previously advised your counsel by telephone, the Exchange is considering the question of whether Intercontinental Industries, Inc. qualifies for continued listing on the Exchange. Trading in the common stock of your Company was halted by this Exchange on June 19, 1969, pending clarification of previous statements concerning acquisitions effected or proposed by the Company. The Exchange has determined not to resume trading in the stock until it has completed its review of this matter and has determined whether further trading on the Exchange in this security is warranted under all of the circumstances.

The Constitution of the Exchange vests in the Board of Governors the authority to suspend dealings in or remove any security from listing. Attached is a copy of

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* Figures in brackets refer to page numbers of original document.

the Exchange's policies with respect to continued listing. Your Company was furnished a copy of these policies shortly after they were revised in February 1968.

You will note that although the Exchange does not rate or evaluate any security dealt in on the Exchange, as a matter of policy, it will consider the suspension of trading, [P. 2] or removal from listing any security when, among other things, in the opinion of the Exchange:

> "(e) any . . . event shall occur or any condition shall exist which makes further dealing on the Exchange in the security unwarranted."

To assist in the application of these policies, the Exchange has adopted certain guidelines under which it will normally give consideration to suspending dealings in, or removing a security from listing. These guidelines provide that events which may give rise to such action include, among others, the failure by a listed company to comply with its listing agreements with the Exchange (including the failure to observe Exchange policies regarding timely disclosure of important corporate developments), and operations by a listed company or its management which, in the opinion of the Exchange, are contrary to the public interest.

As you know, subsequent to the halt in trading in the common stock of your Company, Exchange officials raised a number of questions concerning the activities of certain officers and directors of Intercontinental Industries and Pre Built Homes, Inc., who, on a number of occasions in April, May and June, 1969, prepared and disseminated various statements in the form of press releases, brochures, charts and schedules to the public, to various securities firms and to the financial press concerning the nature of and dollar amount of orders for Pre Built's modular home units, the number of units sold and projected sales and

earnings of Pre Built Homes, Inc. These questions focused upon the inaccurate and misleading nature of such statements and the possible effect which they may have had upon the investing public. Questions were also raised concerning the announcement of the purchase by the Company of an interest in The Central Foundry Company and the possibility of its uniting with Central Foundry and Capital Bancshares Inc. In particular, questions were raised concerning the accuracy of pro forma figures of total assets, net worth, total sales and net income of the three corpora- [P. 3] tions combined. As a result of these discussions and similar discussions between Company officials and the Securities and Exchange Commission, your Company issued a statement, in the form of a letter to stockholders, dated July 18, 1969, which substantially revised and modified the information that had previously been published concerning these acquisitions and which provide additional information of a material nature that should have been disclosed in order to prevent the earlier announcements from being misleading.

The Exchange considers that prompt and accurate disclosure to the public of pertinent information concerning significant corporate developments of a listed company is of critical importance and that failure by the management of a company to diligently comply with this requirement raises serious questions as to whether the Exchange is warranted in permitting continued trading in the securities of the company.

The listing agreement entered into by each listed company with the Exchange provides that:

> "The Corporation will make prompt public disclosure of any material development in its affairs and operations, whether favorable or unfavorable, which might significantly affect the market for its securities or influence investment decisions."

This requirement is further clarified in the listing agreement as follows:

> "It is expected that such statements will be factual and that judgment and restraint will be used in not publicizing information which may be construed as overoptimistic, slanted or promotional—such as estimates and forecasts not warranted by existing circumstances, premature statements of mergers or acquisitions or descriptions of new products still in the experimental stage, the commerical feasibility of which is problematical, etc."

[P. 4]

In the absence of a satisfactory explanation for the misleading and inaccurate information disseminated with respect to the proposed acquisitions by Intercontinental Industries, the Exchange must give consideration to the question of whether it is in the best interests of the investing public to continue the listing.

Before this matter is presented to the Board of Governors, representatives of the Company will be given an opportunity for a hearing before the Exchange's Committee on Securities, to present such facts as the Company feels may have a bearing on the question of continued listing. Please let me know if you or other representatives of the Company wish to meet with the Committee and make a presentation. If you do, I will advise you of the time and place of the meeting as soon as it can be scheduled. In the meantime, any information which the Company wishes to furnish regarding the matters discussed in this letter would be helpful to the Committee in its consideration of the question of continued listing.

Very truly yours,

JOSEPH A. DEROSE

Encl.
cc: Dolph Simon, Esq.